PROFESSOR BLINDER: Thank you, Mr. Chairman, and members of the Commission. By the way, does that yellow light connote a minute, two minutes?

VICE CHAIRMAN PAPADIMITRIOU: It's supposed to be two minutes.

PROFESSOR BLINDER: Two minutes, thank you. I was asked to give you my views on the causes of the trade deficit, its likely consequences and impacts and also some possible solutions, all in 5 to 7 minutes. And so, if you'll excuse the superficiality, I'm going to stick to some main points. In particular, I have only three. And, while you refer to this as a technical hearing, this is not going to be very technical.

In the 1980s, as you all recall, economists worried a lot about the so-called twin deficits, the idea being that increases in the federal budget deficit were making the trade deficit balloon. No one talks about that any more. The 1990s have been extraordinarily different, as the table that I provided at the end of my written testimony shows. I'm sure you've seen this accounting identity before in some other testimonies or in other ways.

I've displayed this standard accounting identity here leaving out the statistical discrepancy, so if you actually try to add these numbers across they're not going to add. So it says that the trade balance is equal to the budget balance plus the difference between private saving and private investment. If the gap between private saving and private investment doesn't change very much, then it follows from this identity that changes in the government budget will indeed cause approximately equal changes in the trade balance. And that, as you see in these numbers, is approximately what happened between 1981 and 1986. The changes in S, private savings, and I, private investment, were roughly equal -- almost exactly equal in fact. And so the very large increase in the budget deficit, $162 billion, fed almost dollar for dollar into the trade deficit -- which increased over those five years by $147 billion.

Now we know that the history of the 1990s was extremely different, particularly between 1992 and 1998. The federal budget deficit disappeared and yet the trade deficit, as you see here in this table, mushroomed from a mere $39 billion, which is six-tenths of a percent of GDP, to a whopping $202 billion, 2.3 percent of GDP, in 1998, and, of course, it's larger in 1999.

So what happened here? Well, the table shows you that the swing in the private saving/investment balance totally overwhelmed even the very sharp increase in government saving. Private investment during this period soared by about 4 percentage points of GDP, which is certainly very good news for the U.S. economy. And I'll remind you, even though you probably don't need to be reminded, that indeed boosting private investment in this way was the primary rationale for smaller budget deficits (now adays budget surpluses.) So the medicine worked extremely well.

Second, however, you see, only a very small increment in dollar terms in private saving. Expressed as a share of GDP, private saving fell from 18.4 percent to just 15.7 percent, as personal saving practically vanished -- in fact, until we revised the data, it had vanished.

The main reason for this sharp drop in personal savings appears to be that the massive wealth creation, especially in the stock market but also elsewhere, reduced the perceived need to save by American households. Now most of us economists feel vaguely uncomfortable seeing the private savings rate hover around zero, but that development, too, is a measure of our success. Americans not only feel richer, they actually are richer -- and that's why they're saving less. So that's my first main point for this morning:

that the trade deficit is largely a product of macroeconomic success, not macroeconomic failure.

Let me turn now to consequences, where my second main point is that, at least up to now, the consequences of this very large trade deficit have been extremely benign. A trade deficit constitutes a subtraction from total demand, and with the U.S. economy on the verge of overheating that subtraction has been more than welcome. Without it, the Federal Reserve would surely have already raised interest rates more aggressively than it has.

Looked at from the point of view of the rest of the world, as Mr. Barbera was a moment ago, this buoyant U.S. demand has helped support what was otherwise a weak world economy in Europe, Asia and elsewhere, because our trade deficit is, of course, their trade surplus. During the year 1998, for example, our country alone accounted for about half of total world growth in demand and it's a good thing that we had it.

Let me turn now to impacts. So is there a dark side to all of this? And again I would say, so far, not very much. The standard economic view is that a trade deficit that's used to finance a consumption boom, which we did in the 1980s, sows problems for the future, but a trade deficit that finances an investment boom doesn't.

Now currently the U.S. trade deficit is financing both a consumption boom and an investment boom. There are, however, incipient worries. One is that the yawning trade deficit will awaken protectionist sentiment in the United States. You can see some stirrings of that already, although so far relatively they are muted, leaving aside Seattle.

Another concern is that we may be setting up the dollar for a very big fall, and that brings me to my third and final point.

I believe that a lower dollar, indeed a much lower dollar, will ultimately play a major role, indeed the major role, in whittling our trade deficit down, not to zero, but to a manageable size. If you look at the implied forward rate in the markets between the yen and the dollar, based on the 10-year bond rates, it's hovering around 70 yen to the dollar -- which is a stunning number to think about, but not a totally crazy number for 10 years from now.

Other than the dollar, what else might help? Well, we certainly don't want to cut American investment, which is a big source of this deficit. If I had any great ideas for boosting private saving, I'd give them you to right now, but I'm skeptical that anybody has any great ideas. And finally, if we could induce faster growth abroad, as Bob Barbera suggested, that would be very, very good.

Finally, in my last millisecond, getting the dollar down will not require what is sometimes called a weak dollar policy. The market will do it for us. I think the problem for public policy is simply to cope with the sinking dollar as it sinks.

Thank you.

VICE CHAIRMAN PAPADIMITRIOU: Thank you, very, very much.

Professor Godley?